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## POLLUTION CONTROL BONDS: DEVELOPING CASE LAW IN THE STATES

*Richard Friedman\**

### INTRODUCTION

In 1968, Congress amended § 103 of the Internal Revenue Code to remove the tax-exempt status which had been accorded industrial development bonds.<sup>1</sup> More precisely, Congress reallocated the federal income tax exemption, removing it from most industrial development bonds, but exempting certain new categories of bonds, including those bonds whose proceeds were to be used for the construction of air or water pollution control facilities. These pollution control bonds have proven to be extremely popular, and since 1971 sales volume has increased dramatically.<sup>2</sup> The majority of states have legislation authorizing municipalities to issue pollution control bonds<sup>3</sup> and industry is clearly willing to use the bonds as a major

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<sup>1</sup> INT. REV. CODE OF 1954, § 103(c).

<sup>2</sup> In 1971, public sales of pollution control bonds totaled \$76,750,000. In 1973, sales had increased to \$1.7 billion and by 1975 total public sales equaled \$2.1 billion. The Weekly Bond Buyer, January 26, 1976, at 1, col. 4. Emphasizing the number of variables, two economists have estimated that 1976 sales could total from \$2.8 billion to \$7.5 billion, while 1980 sales could total between \$2 billion and \$4.5 billion. Peterson and Galper, *Tax Exempt Financing of Private Industry's Pollution Control Investment*, 23 PUBLIC POLICY 81, 88 (1975) [hereinafter cited as Peterson and Galper].

<sup>3</sup> The following thirty-six states have authorized the issuance of municipal bonds to finance private pollution control facilities: CODE OF ALA. tit. 8, § 270 *et seq.* (Supp. 1973); ARIZ. REV. STAT. § 9-1221 *et seq.* (Supp. 1975); CAL. HEALTH AND SAFETY CODE § 39600 *et seq.* (West 1973); CONN. GEN. STAT. ANN. § 32-23c *et seq.* (Supp. 1975); DEL. CODE ANN. tit. 6, § 7001 *et seq.* (1974); FLA. STAT. ANN. § 159.25 *et seq.* (1972); HAWAII REV. STAT. tit. 5, § 39-125 *et seq.* (Supp. 1974); IDAHO CODE § 31-4501 *et seq.* (Supp. 1975); ILL. ANN. STAT. ch. 127, § 721 *et seq.* (Supp. 1975); IND. STAT. ANN. § 18-6-4.5-1 *et seq.* (1974); IOWA CODE ANN. § 419.1 *et seq.* (Supp. 1975); LA. STAT. ANN.—REV. STAT. § 39:991 *et seq.* (Supp. 1975); ME. REV. STAT. ANN. tit. 30, § 5325 *et seq.* (Supp. 1973); ANN. CODE OF MD. art. 41, § 266A *et seq.* (Supp. 1975); MASS. ANN. LAWS ch. 121C, § 1 *et seq.* (Supp. 1975); MICH. STAT. ANN. § 5.3533(22) *et seq.* (Supp. 1975); MINN. STAT. ANN. § 474.01 *et seq.* (Supp. 1975); ANN. MO. STAT. § 260.005 *et seq.* (Supp. 1975); NEV. REV. STAT. § 244.9191 *et seq.* (1973); N.J. STAT. ANN. § 40:37C - 1 *et seq.* (Supp. 1975); N.M. STAT. § 14-60-1 *et seq.* (Special Supp. 1975); N.Y. GEN. MUN. LAW § 850 *et seq.* (McKinney 1974); N.D. CENT. CODE § 40-57-01 *et seq.* (Supp. 1975); OHIO REV. CODE ANN. § 3706.01 *et seq.* (1971); ORE. REV. STAT. § 468.263 *et seq.* (1974); PA. STAT. ANN.

source of financing for pollution control facilities.<sup>4</sup> As a result, the bonds will, in part, determine how quickly and in what manner industry complies with federal, state, and local environmental regulations.

Pollution control bonds have been a steady source of litigation in state courts since 1971 when their use became widespread. At present, the great majority of the states which have ruled on the bonds have held them valid.<sup>5</sup> A minority, however, hold that the bonds violate either the public purpose doctrine or the credit clause of the state constitution.<sup>6</sup> This split can be explained by the courts' differing interpretations of the credit clause and the public purpose doctrine and, underlying those interpretations, a fundamental philosophical difference concerning the use of public aid to induce and assist corporate compliance with pollution control regulations.

The purpose of this article is to discuss the state case law on pollution control bonds, to analyze the majority and minority view, and to offer a conclusion as to a proper judicial approach. As background for that discussion, the general concept of industrial development bonds and the 1968 tax reform which formally sanctioned pollution control bonds must first be discussed.

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tit. 73, § 371 *et seq.* (Supp. 1975); GEN. LAWS R.I. § 45-37.1-1 *et seq.* (Supp. 1975); S.C. CODE § 14-399.21 *et seq.* (Supp. 1975); S.D. COMP. LAWS § 9-54-1 *et seq.* (Supp. 1975); TENN. CODE ANN. § 6-2801 *et seq.* (Supp. 1975); UTAH CODE ANN. § 11-17-1 *et seq.* (Supp. 1975); VT. STAT. ANN. tit. 10, § 211 *et seq.* (Supp. 1975); CODE OF VA. § 15.1-1373 *et seq.* (1973); W.VA. CODE § 13-2C-1 *et seq.* (Supp. 1975); WIS. STAT. ANN. § 66.521(1) *et seq.* (Supp. 1975); WYO. STAT. § 15.1-92 *et seq.* (Supp. 1975). Although the above statutes specifically make mention of pollution control facilities as permissible projects, issuance of pollution control bonds has not required that express inclusion. See cases cited note 40 *infra*.

<sup>4</sup> Pollution control investment by private industry in 1973 was estimated to total \$6.2 billion. Pollution control bond sales for 1973 totaled \$1.8 billion, almost 30% of the projected total investment. Peterson and Galper, *supra* note 2, at 89, citing 6TH ANNUAL SURVEY OF POLLUTION CONTROL EXPENDITURES, McGraw-Hill Economics Dep't (1973).

<sup>5</sup> Eleven states have upheld pollution control bonds: Knight v. Environmental Improvement Authority, 287 Ala. 15, 246 So.2d 903 (1971); Indus. Authority v. Nelson, 109 Ariz. 368, 509 P.2d 705 (1973); State v. County Dev. Authority, 249 So.2d 6 (Fla. 1971); Wilson v. Bd. of County Comm'rs, 273 Md. 30, 327 A.2d 488 (1974); State *ex rel.* Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority, 518 S.W.2d 68 (Mo. 1975); Fickes v. Missoula County, 155 Mont. 258, 470 P.2d 287 (1970); State *ex rel.* Brennan v. Bowman, 89 Nev. 330, 512 P.2d 1321 (1973); Kennecott Copper Corp. v. Town of Hurley, 84 N.M. 743, 507 P.2d 1074 (1973); Harper v. Schooler, 258 S.C. 486, 189 S.E.2d 284 (1972); Nemelka v. Salt Lake County, 28 Utah 2d 183, 499 P.2d 862 (1972); State *ex rel.* Hammermill Paper Co. v. La Plante, 58 Wis.2d 32, 205 N.W.2d 784 (1973).

<sup>6</sup> Opinion of the Justices, 359 Mass. 769, 268 N.E.2d 149 (1971) (loan of credit); Stanley v. Dep't of Conservation and Dev., 284 N.C. 15, 199 S.E.2d 641 (1973) (no public purpose); Port of Longview v. Taxpayers, 84 Wash.2d 475, 527 P.2d 263 (1974), *modified*, 85 Wash.2d 216, 533 P.2d 128 (1975) (loan of credit).

## I. INDUSTRIAL DEVELOPMENT BONDS

An industrial development bond is a revenue bond,<sup>7</sup> the proceeds of which are used to finance the construction of industrial facilities for private corporations. The municipality issues the bonds in its name,<sup>8</sup> uses the proceeds to erect the facility and leases it to a previously determined corporation. The rent is set so as to equal the principal and interest payments due the bondholders.<sup>9</sup> When the leasehold term has expired, the rent payments have retired the bonds. The corporation may then have the option to renew the lease or purchase the facility, in either case for a nominal sum.<sup>10</sup> Because industrial development bonds are generally revenue bonds and not general obligation bonds, the issuing municipality does not pledge its faith and credit or taxing power in support of the bonds.<sup>11</sup> The bondholder must depend on the credit of the corporation using the bonds for payment of the principal and interest.<sup>12</sup>

The tax-exempt status of industrial development bonds, prior to the 1968 legislation, was their *raison d'être*. Without the tax exemption, the bonds would offer no benefit over taxable borrowing to a private corporation, and could not be used by municipalities to induce corporate relocation. Prior to 1968, the Treasury considered the bonds to be an "obligation" of the issuing municipality under §103(a) of the Internal Revenue Code and therefore tax-exempt, even though the municipality did not pledge its general credit or

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<sup>7</sup> In a small number of states, the industrial development bonds have been general obligation bonds rather than revenue bonds. *E.g.*, *Albritton v. City of Winona*, 181 Miss. 75, 178 So. 799 (1938); *City of Frostburg v. Jenkins*, 215 Md. 9, 136 A.2d 852 (1957). For purposes of this article, the terms "industrial development bond" and "pollution control bond" shall refer only to tax-exempt revenue bonds.

<sup>8</sup> The bonds are not issued solely by municipalities. The issuing body may be the state, a county, or state- or county-wide pollution control authority. *See* note 45, *infra*. For purposes of this article, the term "municipality" shall include all of the above.

<sup>9</sup> The rent payments may also include fees, administrative expenses, and other charges incurred by the issuing municipality. *E.g.*, *Uhls v. State ex rel. City of Cheyenne*, 429 P.2d 74, 77 (Wyo. 1967).

<sup>10</sup> *E.g.*, *City of Gaylord v. Beckett*, 378 Mich. 273, 144 N.W.2d 460 (1966) (option to purchase for \$1). Note the lease used in *State ex rel. Hammermill Paper Co. v. La Plante*, 58 Wis.2d 32, 205 N.W.2d 784 (1973), contained in Mulcahy and Guskowski, *The Financing of Corporate Expansion Through Industrial Revenue Bonds*, 57 MARQ. L. REV. 201, 223 (1974), where the corporation had three options to renew for 5 year terms at a rent of \$100 per month.

<sup>11</sup> 15 E.McQUILLAN, MUNICIPAL CORPORATIONS § 43.11 (J.LATTA, 3d ed. 1970 Rev. Vol.).

<sup>12</sup> Because industrial development bonds are backed by the credit rating of the borrowing corporation and not by the issuing municipality, they sell at a slightly higher interest rate than general obligation bonds. *The Row Over Municipal Industrials*, FORTUNE, Feb., 1968, at 191.

taxing power in support of the bonds.<sup>13</sup> Section 103(a), in turn, has its constitutional base in *Pollack v. Farmers Loan and Trust Co.*, in which the Supreme Court held that federal taxation of municipal bond interest was in effect a direct federal tax on the borrowing power of the States and therefore a violation of the separation of powers doctrine.<sup>14</sup>

Industrial development bonds first appeared in the South during the depression,<sup>15</sup> and for a number of years the concept stayed south. In 1961, only six southern states and Puerto Rico issued industrial development bonds.<sup>16</sup> From 1962 to 1968, however, a number of statistics measuring different aspects of industrial development bond usage all evidenced a rapid increase.<sup>17</sup> Public sales of the bonds increased from \$70 million in 1961 to nearly \$500 million in 1966 and to \$1.3 billion in 1967.<sup>18</sup> Clearly, industrial development bonds were no longer a method used solely by developing southern states to finance small industrial plants. By 1967, the bonds were issued by more industrial states to finance large industrial projects for major corporations.<sup>19</sup>

The causes of this increase in sales are clear. By financing plant construction with tax-exempt bonds, which sell at a lower interest rate than normal corporate bonds, corporations are able to save large sums of money.<sup>20</sup> One commentator contended that a corporation could show a net profit simply by occupying a site financed by

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<sup>13</sup> Rev. Rul. 54-106, 1954-1 CUM. BULL. 28.

<sup>14</sup> 157 U.S. 429 (1895). The validity of the holding in *Pollack* has been questioned. Note, *The Continuing Debate Over the Municipal Bond Exemption: Time For a New Approach by Reformists*, 25 SYRACUSE L. REV. 953, 958 n.26 (1974).

<sup>15</sup> Mississippi was the first state to authorize industrial development bonds; the program, *Balance Agriculture With Industry*, was upheld in *Albritton v. City of Winona*, 181 Miss. 75, 178 So. 799 (1938).

<sup>16</sup> 114 CONG. REC. 7683 (1968). For additional statistics on pre-1963 use of industrial development bonds, see Pinsky, *State Constitutional Limitations on Public Industrial Financing: an Historical and Economic Approach*, 111 U. PA. L. REV. 265, 326 (1963) [hereinafter cited as Pinsky].

<sup>17</sup> For numerous statistics on industrial development bond use from 1956 to 1967, see 114 CONG. REC. 909, 7683 (1968).

<sup>18</sup> 114 CONG. REC. 7683 (1968). It was estimated that private sales could be two or three times as great. *Id.* at 909 n.1.

<sup>19</sup> See Table, *Industrial Aid Financing by State 1956-1967*, 114 CONG. REC. 7683 (1968); Table III—*Industrial Development Bonds Issued in 1967 (Large Issues Only)*, 114 CONG. REC. 909 (1968).

<sup>20</sup> One commentator, discussing pollution control bonds, estimates that a corporation can save \$300,000 over 20 years on a \$1 million issue if the difference between the interest rate on taxables and tax-exempts is 1.5%. Ritts, *Financing the Future Demand For Electric Energy and Pollution Control Facilities—The Tax Exempt Bond*, 5 NAT. RES. LAW. 363 (1972).

industrial development bonds and purchasing the bonds itself.<sup>21</sup> A second major impetus to bond use was an increase in competition among states to attract new industry and between corporations to keep costs low.<sup>22</sup>

Notwithstanding the \$800 million increase in bond sales in 1966-1967, the bonds were proving less popular in many quarters. In late 1967, legislation was introduced in the Senate to lift the municipal tax exemption from industrial development bonds.<sup>23</sup> The ensuing Congressional debate revealed that some states and corporations felt obligated to issue and use the bonds but believed them to be counterproductive.<sup>24</sup> Opponents of industrial development bonds argued that the rapidly increasing volume of these bonds was causing the interest rate on all municipal bonds to rise, thus driving up municipal costs for roads, sewers, schools, etc.<sup>25</sup> In addition, by 1968, over forty states had authorized industrial development bonds, and members of Congress repeatedly pointed out that the individual municipality issuing bonds no longer had any competitive advantage regarding corporate relocation decisions.<sup>26</sup> In effect, opponents argued that Congress, by severely limiting the number of industrial development bonds, would be saving the municipalities from themselves.<sup>27</sup>

The federal government also had its own interests to protect. By allowing municipalities to pass on the benefits of their tax-exempt

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<sup>21</sup> Note, *Industrial Development Bonds: Judicial Construction vs. Plant Construction*, 15 U. FLA. L. REV. 262, 270 (1962). One result of the 1968 reform legislation was to prohibit a corporation from holding the bonds and being a "substantial user" of the facilities. INT. REV. CODE OF 1954, § 103(c)(7). Nor are rent payments still deductible as a business expense. REV. RUL. 68-590, 1968-2 CUM. BULL. 66.

<sup>22</sup> For legislative recognition of the interstate competition factor see, WIS. STAT. § 66.521(1) (Supp. 1975).

<sup>23</sup> S.2635, 90th Cong., 1st Sess. (Nov. 8, 1967).

<sup>24</sup> See 114 CONG. REC. 905-07 (1968). For Congressional discussion of industrial development bonds, see generally 114 CONG. REC. 905, 7681, 8145 (1968). For a comprehensive discussion of the 1968 legislation and the policy questions raised by industrial development bonds, see McDaniel, *Federal Income Taxation of Industrial Bonds: The Public Interest*, 1 URBAN LAW 157 (1969).

<sup>25</sup> The Investment Banker's Association estimated that the 1966-1967 \$800 million increase in industrial development bond sales raised the cost of local government borrowing with general obligation bonds by about  $\frac{1}{4}$  of 1 per cent. 114 CONG. REC. 7681 (1968) (Remarks of Senator Nelson).

<sup>26</sup> 114 CONG. REC. 8147, 8149, 8150 (1968).

<sup>27</sup> North Carolina illustrates the approach/avoidance problems some states had with industrial development bonds. Although the North Carolina legislature authorized issuance of the bonds, it passed a second bill at the same time asking the President and the other 49 states to urge Congress to remove the bond's tax-exempt status. *Mitchell v. Indus. Dev. Fin. Authority*, 273 N.C. 137, 146, 159 S.E.2d 745, 748 (1968).

status to private corporations, the federal government was spending tax revenue to subsidize the cost of building private industrial plants.<sup>28</sup> In addition to causing an absolute loss of tax revenue, the Treasury also argued that industrial development bonds were fiscally inefficient; the federal government lost the entire amount of the tax which would have been collected on the interest paid on the bonds, while the corporation gained the difference between the interest rate on tax-exempt and taxable bonds. The Treasury estimated that the dollar loss to the federal government could be three times as great as the dollar benefit to the corporation using the bonds.<sup>29</sup>

The resulting legislation, contained in the Revenue and Expenditure Control Act of 1968 [the Act],<sup>30</sup> is not a blanket restriction on all future use of industrial development bonds. It is an attempt to limit a municipality's power to pass on the benefits of its tax-exempt status to a private corporation while maintaining certain types of tax-exempt bonds which Congress presumably considered most beneficial. The Act retains the tax-exempt status for two classes of industrial development bonds. First, the Act creates an exemption for small issues and small projects. Congress heard arguments that industrial development bonds are still a necessity for small communities and rural areas.<sup>31</sup> In an apparent compromise, the Act provides a tax exemption for issues that are \$1 million or

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<sup>28</sup> The tax expenditure theory regards each income tax deduction as revenue lost to the federal government; thus, each tax deduction is seen as equivalent to a positive appropriation of federal funds by Congress. As applied to the tax exemption for industrial development and pollution control bonds, the result is the same as if Congress had made a positive appropriation specifically to finance industrial plants and private pollution control facilities. The tax deduction can then be analyzed for fiscal efficiency and effectiveness as would any statutory appropriation. For application of the tax-expenditure theory to accelerated depreciation deductions for pollution control facilities, see McDaniel and Kaplinsky, *The Use of the Federal Income Tax System to Combat Air and Water Pollution: A Case Study in Tax Expenditures*, 1 ENV. AFF. 12 (1971).

<sup>29</sup> 114 CONG. REC. 905, 908-09 (1968). This loss of funds is not peculiar to industrial development or pollution control bonds. The tax exemption for interest on municipal bonds will probably cost the federal government \$4.7 billion in lost revenue in fiscal 1976 while states and cities will save less than \$3 billion. The \$1.7 billion difference goes directly to the bondholders as tax-free income. Crown, *Federal Subsidy For Municipal Bonds: An Appraisal*, TAX NOTES, Oct. 20, 1975, at 27, citing Estimates of Federal Tax Expenditures, Treasury Department and Joint Committee on Internal Revenue (July 8, 1975). The Crown article discusses the possibility of substituting a taxable municipal bond and a direct federal subsidy to municipalities for the present indirect subsidy through tax exemption. For other discussion of the taxable municipal bond, see Note, *The Continuing Debate Over the Municipal Bond Exemption: Time For a New Approach by Reformists*, 25 SYRACUSE L. REV. 953 (1974).

<sup>30</sup> Pub. L. No. 90-364, 82 Stat. 251, amending INT. REV. CODE OF 1954, § 103.

<sup>31</sup> 114 CONG. REC. 7687 (1968) (Remarks of Senator Fulbright).

less, regardless of the total size of the particular project, and issues as large as \$5 million, if the total cost of the project is \$5 million or less.<sup>32</sup> This "small issues exemption" has been supported by a commentator otherwise critical of industrial development bonds as encouraging the most economically beneficial projects.<sup>33</sup>

The second statutory exception concerns bonds whose proceeds are to be used for a variety of specific projects such as sports facilities, airports, mass commuting facilities, and air or water pollution control projects.<sup>34</sup> The projects may be of unlimited size and the bond proceeds may be used by a private corporation. However, unlike the typical pre-1968 project, *i.e.*, private industrial facilities, the §103(c)(4) projects must be available on a regular basis for general public use or be part of a facility so used.<sup>35</sup> Air and water pollution control facilities are an exception and are treated as serving a general use even though the facilities are built for a private plant.<sup>36</sup> Thus, since 1968 the major opportunity left for a private corporation to use industrial development bonds to finance plant construction costs in excess of \$5 million has been through the exemption for pollution control facilities.

## II. POLLUTION CONTROL BONDS

Of all the exceptions allowed under § 103(c)(4)-(5), the most heavily used has been the exception for pollution control facilities.<sup>37</sup> In 1975, total public sales of the bonds rose to \$2.1 billion, \$800 million more than the total of all industrial development bonds sold in 1967.<sup>38</sup>

Although pollution control bonds are tax-exempt by virtue of § 103(c)(4)(F) of the Internal Revenue Code, they are issued in individual states as a result of state enabling legislation. The bonds are issued under three different statutory schemes. In the least common scheme, the state statute under which the bonds are issued

<sup>32</sup> INT. REV. CODE OF 1954, § 103(c)(6). Senator Curtis has introduced legislation to raise the \$1 million ceiling to \$10 million, S.1949, 94th Cong., 1st Sess. (June 16, 1975).

<sup>33</sup> Note, *The Limited Tax-Exempt Status of Interest on Industrial Development Bonds Under Subsection 103(c) of the Internal Revenue Code*, 85 HARV. L. REV. 1649, 1660 (1972).

<sup>34</sup> INT. REV. CODE OF 1954, § 103(c)(4)-(5).

<sup>35</sup> Treas. Reg. § 1.103-8(a)(2) (1972).

<sup>36</sup> *Id.*

<sup>37</sup> 1974 sales of industrial bonds for non-pollution control purposes were \$337 million compared to \$2.1 billion for pollution control bonds. *The Weekly Bond Buyer*, Jan. 13, 1975, at 1, col. 1.

<sup>38</sup> *The Weekly Bond Buyer*, Jan. 26, 1976, at 1, col. 4.



contains no express mention of pollution control facilities.<sup>39</sup> Typically, such a statute was passed before 1968 to authorize industrial development bonds and finance plant construction. Although the statutory definition of "project" does not expressly authorize the construction of pollution control facilities, several courts have held that a definition which does include "enlargements," "improvements," or "additions" is sufficiently broad to include authorization for their construction.<sup>40</sup>

The two more common approaches are either to amend a preexisting industrial development bond statute to include express authorization for pollution control bonds,<sup>41</sup> or to pass an independent statute authorizing the issuance of revenue bonds for pollution control facilities.<sup>42</sup> The latter group of statutes normally follow this pattern: legislative findings as to the existence of pollution and the desirability of providing alternative methods of financing the necessary private pollution control facilities;<sup>43</sup> definitions of pollution and pollution control facilities;<sup>44</sup> a description of the powers of the issuing body;<sup>45</sup> a description of the type of bonds authorized;<sup>46</sup> and other regulations as to state tax exemptions<sup>47</sup> or required certification by federal or state agencies.<sup>48</sup>

Numerous cases have questioned whether this enabling legisla-

<sup>39</sup> *E.g.*, REV. CODE OF MONT. § 11-4101 *et seq.* (1968), *as amended*, (Supp. 1974).

<sup>40</sup> *Fickes v. Missoula County*, 155 Mont. 258, 270, 470 P.2d 287, 293 (1970); *State v. County Dev. Authority*, 249 So.2d 6, 10 (Fla. 1971).

<sup>41</sup> *E.g.*, ANN. CODE OF MD. art. 41, § 266A *et seq.* (Supp. 1975), *amending* ANN. CODE OF MD. art. 41, § 266A *et seq.* (1971).

<sup>42</sup> *E.g.*, ANN. MO. STAT. § 260.005 *et seq.* (Supp. 1975).

<sup>43</sup> *E.g.*, CAL. HEALTH AND SAFETY CODE § 39601 (West 1973); IDAHO CODE § 31-4502 (Supp. 1975). For legislative findings stressing use of pollution control bonds as a means of retaining present industry and attracting new industry, see ANN. CODE OF MD. art. 41, § 266B(a)-(b) (Supp. 1975).

<sup>44</sup> "Pollution" has been broadly defined as, "[a]ny form of environmental pollution including, but not limited to, water pollution, air pollution, land pollution, solid waste pollution, thermal pollution, radiation contamination, or noise pollution as determined by the various standards prescribed by this state or the federal government." IDAHO CODE § 31-4503(d) (Supp. 1975). For a detailed definition of "pollution control facilities," see CAL. HEALTH AND SAFETY CODE § 39603(e) (West 1973).

<sup>45</sup> The issuing body may be a state authority, as in Missouri: ANN. MO. STAT. § 260.010 (Supp. 1975); or a county or municipality: ANN. CODE OF MD. art. 41, § 266B (1971).

<sup>46</sup> Those statutes which authorize revenue bonds contain a disclaimer of municipal liability such as the following: "[s]uch revenue bonds shall not be secured by the full faith and credit or the taxing power of the state of Idaho or of any political subdivision thereof, and such limitation shall be plainly printed on the face of each such revenue bond." IDAHO CODE, § 31-4505 (Supp. 1975).

<sup>47</sup> *E.g.*, IDAHO CODE § 31-4515 (Supp. 1975).

<sup>48</sup> *E.g.*, CAL. HEALTH AND SAFETY CODE § 39615 (West Supp. 1975).

tion violates a variety of state constitutional provisions. Although each case contains its own unique set of issues, the outcome is nearly always determined by the judicial response to two particular issues. The first issue is whether the bonds violate that section of a typical state constitution which prohibits municipalities from loaning their credit in aid of private corporations. The second is whether pollution control bonds serve a public purpose. The remainder of this article will discuss how state courts have confronted these two issues.<sup>49</sup>

### A. Credit Restrictions

In the context of municipal bonds, the latter half of the 19th century has assumed historic proportions as the "railroad bond era." It was during this period that many municipalities issued and sold general obligation bonds and loaned the proceeds to private corporations. The principal recipients of the funds were railroads, which municipalities wanted to encourage to lay track as quickly as possible within the state.<sup>50</sup> State courts applied the traditional public purpose test to the bonds and did not find them wanting.<sup>51</sup> When a number of railroads went bankrupt and left the municipalities liable for the bonds, states began to pass various constitutional restrictions aimed at preventing other such loans. The Arizona credit restriction is a good example of a constitutional restriction aimed at several "railroad bond" practices:

Neither the State, nor any county, city, town, municipality, or other subdivision of the State shall ever give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation, or become a subscriber to, or a shareholder in, any company or corporation, or become a joint owner with any

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<sup>49</sup> Although the credit restriction and the public purpose doctrine are the principal issues, several others arise frequently; whether the bonds exceed the municipal debt limit, *e.g.*, *Harper v. Schooler*, 258 S.C. 486, 494, 189 S.E.2d 284, 288 (1972); whether the project is a "work of internal improvement" which the state constitution prohibits the state from participating in, *e.g.*, *State ex rel. Hammermill Paper Co. v. La Plante*, 58 Wis.2d 32, 59, 205 N.W.2d 784, 800 (1973); state tax questions, *e.g.*, *State ex rel. Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority*, 518 S.W.2d 68, 75 (Mo. 1975); and whether pollution control facilities fall within the statutory definition of "project", see cases cited *supra* note 40.

<sup>50</sup> See Pinsky, *supra* note 16, at 277; Note, *State Constitutional Limitations on a Municipality's Power to Appropriate Funds or Extend Credit to Individuals and Associations*, 108 U. PA. L. REV. 95, 97 (1959) [hereinafter cited as *State Constitutional Limitations*].

<sup>51</sup> *State Constitutional Limitations*, *supra* note 50, at 97; *Sharpless v. Mayor of Philadelphia*, 21 Pa. 147 (1853).

person, company or corporation, except as to such ownerships as may accrue to the State by operation or provision of law.<sup>52</sup>

Of the several restrictions contained in the Arizona credit clause, the pollution control bond cases deal principally with that part which prohibits a municipality from giving or loaning its credit in aid of a private corporation. No disagreement exists in the case law that the bonds can be seen as a loan<sup>53</sup> and that the loan does aid a private corporation.<sup>54</sup> In the majority view, and that of the court in *Port of Longview, Cowlitz County v. Taxpayers*, the only case to hold that pollution control revenue bonds are prohibited by credit restrictions,<sup>55</sup> the determinative issue is whether that loan to a private corporation is a loan of municipal credit.

As did earlier cases involving industrial development bonds,<sup>56</sup> the pollution control bond cases which have decided the credit issue on its merits have interpreted credit restrictions as prohibiting the issuing municipality from obligating or indebting itself through loans to private corporations.<sup>57</sup> The credit issue in most of these cases is reduced to determining whether the tax-exempt pollution control bonds will indebt or obligate the issuing municipality.<sup>58</sup> The

<sup>52</sup> ARIZ. CONST. art. 9, § 7.

<sup>53</sup> See, e.g., *Indust. Dev. Authority v. Nelson*, 109 Ariz. 368, 371, 509 P.2d 705, 708 (1973); *Harper v. Schooler*, 258 S.C. 486, 491, 189 S.E.2d 284, 286 (1972).

<sup>54</sup> See, e.g., *State v. County Dev. Authority*, 249 So.2d 6, 12 (Fla. 1971); *Opinion of the Justices*, 359 Mass. 769, 268 N.E.2d 149 (1971).

<sup>55</sup> 84 Wash.2d 475, 527 P.2d 263 (1974), *modified*, 85 Wash.2d 216, 533 P.2d 128 (1975) [hereinafter cited as *Port of Longview*]. In *Opinion of the Justices*, 359 Mass. 769, 268 N.E.2d 149 (1971), the court held that the statute did violate the credit restriction; however, the Massachusetts statute was unusual in that it employed general obligation bonds rather than the more prevalent revenue bonds. In this sense, *Port of Longview* is the only case to hold that pollution control bonds are barred by state credit restrictions.

<sup>56</sup> There is a good deal of state case law regarding industrial development bonds. For a list, see *Mitchell v. Indus. Dev. Fin. Authority*, 273 N.C. 137, 148-49, 159 S.E.2d 745, 753 (1968). For typical discussions of credit restrictions, see *Elliot v. McNair*, 250 S.C. 75, 156 S.E.2d 421 (1967); *Allen v. Tooele County*, 21 Utah 2d 383, 445 P.2d 994 (1968); *Uhls v. State*, 429 P.2d 74 (Wyo. 1967).

<sup>57</sup> *Harper v. Schooler*, 258 S.C. 486, 495, 189 S.E.2d 284, 288 (1972); *State ex rel. Brennan v. Bowman*, 89 Nev. 330, 333, 512 P.2d 1321, 1322-23 (1973); *Kennecott Copper Corp. v. Town of Hurley*, 84 N.M. 743, 746, 507 P.2d 1074, 1077 (1973); *Opinion of the Justices*, 359 Mass. 769, 773, 268 N.E.2d 149, 152 (1971). In two cases no violation of the credit restriction was found on the ground that the particular issuing entity was not barred by the clause. *Knight v. Environmental Improvement Authority*, 287 Ala. 15, 19, 246 So.2d 903, 905 (1971) (public corporation neither "state" nor "political subdivision"); *State ex rel. Hammermill Paper Co. v. La Plante*, 58 Wis.2d 32, 61-62, 205 N.W.2d 784, 801-02 (1973) (municipality not bound by constitutional restriction on acts of state).

<sup>58</sup> A number of courts have taken a different route, positing that bonds which are issued for a public purpose are an exception to the constraints of the credit restriction. *Fickes v. Missoula County*, 155 Mont. 258, 267-68, 470 P.2d 287, 291-92 (1970); *Kennecott Copper*

reasoning of the Nevada Supreme Court in *State ex rel. Brennan v. Bowman*<sup>59</sup> is typical:

It is asserted that the Revenue Bond Law contravenes the prohibitions of Nev. Const. art. 8, §§ 9 and 10, relative to loans of public credit. Since the Revenue Bond Law specifically forbids a charge against the County's credit or taxing powers, precludes County liability for the bonds and interest coupons, and bars County contribution towards the acquisition cost of the project, this challenge to the law also must fail. . . . Inasmuch as the bonds are payable only from income to be derived from leasing the pollution control facilities, and no resort can be had against the County or its taxpayers, the County is not lending its credit in breach of the constitutional proscription.<sup>60</sup>

The *Brennan* interpretation of the Nevada credit restriction is consistent with the history and purpose of credit restrictions in general. The original credit restrictions were a reaction to a particular state of affairs: massive municipal debts caused by municipal loans to private corporations. Revenue bonds, one of whose primary features was limited municipal liability, were not widely used until the Depression.<sup>61</sup> Thus, by construing the credit restrictions so as to focus on the possibility of municipal liability, the courts have not expanded the restrictions' scope beyond that originally intended by their drafters.<sup>62</sup>

In *Port of Longview*, the Washington Supreme Court, however, struck down a statute authorizing pollution control bonds by reading the credit restriction more broadly than as a prohibition against certain types of municipal debt. The Washington credit restriction

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*Corp. v. Town of Hurley*, 84 N.M. 743, 746, 507 P.2d 1074, 1077 (1973) [hereinafter cited as *Kennecott*]; *Indust. Dev. Authority v. Nelson*, 109 Ariz. 368, 373-74, 509 P.2d 705, 710-11 (1973) [hereinafter cited as *Nelson*]; *State ex rel. Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority*, 518 S.W.2d 68, 74 (Mo. 1975). All have proceeded to find a public purpose and uphold the bonds. *Note Kennecott*, where the court appeared to require both a finding of public purpose and no municipal obligation. *Note also City of Tempe v. Pilot Properties Inc.*, 22 Ariz. App. 356, 527 P.2d 515 (1974), a non-pollution control bond case, where the court expressly refused to make an exception for "public purpose" bonds and interpreted *Nelson* as based on a finding of no municipal obligation.

The "public purpose" exception to credit restrictions has been criticized for depriving the restriction of its original purpose: to provide a stricter limit than the public purpose doctrine on municipal assistance to private corporations. *State Constitutional Limitations*, *supra* note 50 at 111; Comment, *State Constitutional Provisions Prohibiting The Loaning Of Credit To Private Enterprise—A Suggested Analysis*, 41 U. COLO. L. REV. 135, 139 (1969).

<sup>59</sup> 89 Nev. 330, 512 P.2d 1321 (1973) [hereinafter cited as *Brennan*].

<sup>60</sup> *Id.* at 333, 512 P.2d at 1322-23.

<sup>61</sup> Fordham, *Revenue Bond Sanctions*, 42 COLUM. L. REV. 395, 400 (1942).

<sup>62</sup> For judicial cognizance of this history, see *Indust. Dev. Authority v. Nelson*, 109 Ariz. 368, 372, 509 P.2d 705, 709 (1973).

provides that a municipality shall not "loan its *money or credit*" in aid of any corporation<sup>63</sup> (emphasis added). In *Port of Longview*, the court held that pollution control bonds constituted both types of loans. The facts giving rise to the case are slightly different from the typical pollution control bond case. Normally, the municipality owns the facility and leases it to the corporation. In *Port of Longview*, the corporation received a lump sum from the municipality to finance construction costs. This lump sum bought the municipality a leasehold interest in the to-be-constructed facilities. The corporation then subleased the facilities back from the municipality and the rent payments on this sublease went to retire the bonds. Prior to *Port of Longview*, Washington aligned itself with those states which had held industrial development bonds unconstitutional.<sup>64</sup> In *Port of Longview*, the municipal respondents apparently anticipated similar constitutional difficulties and thus argued that this transaction was a lease-sublease and not a loan.

The court demonstrated, first, that the municipality was making a loan of its money. As the first element of proof, the court characterized the monies raised by the bonds and ultimately used by the corporation as "municipal funds."<sup>65</sup> This conclusion was based on the finding that "[t]he bonds were issued by the municipal corporation, and the proceeds from their sale came into the municipal treasury."<sup>66</sup> In addition, the court found that the bonds were liabilities of the issuing municipalities. Although the court recognized that the bonds were to be retired solely from the corporate rent payments and not from taxes, it appeared to find persuasive the fact that the bonds themselves stated that the issuing municipality obligated itself to pay the principal.<sup>67</sup>

As its second element of proof, the court concluded that the trans-

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<sup>63</sup> WASH. CONST. art. 8, § 7.

<sup>64</sup> See *Hogue v. Port of Seattle*, 54 Wash. 2d 799, 341 P.2d 171 (1959), in which the Washington court held that the use of eminent domain to assemble land for private industrial development was for a private purpose and therefore invalid.

<sup>65</sup> *Port of Longview v. Taxpayers*, 84 Wash.2d 475, \_\_\_, 527 P.2d 263, 266 (1974), *modified*, 85 Wash.2d 216, 533 P.2d 128 (1975).

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* The court appears to take this statement of obligation literally. It does not consider the statutory limitation of municipal liability, see note 74 *infra*, which also must appear on the face of the bond. The court noted that in the event of default, the bondholders may proceed only against the corporate owner-sublessee, but characterized that as a "contractual affirmative defense" and did not discuss it further. 84 Wash.2d at \_\_\_, 527 P.2d at 265. The statement on the face of the bond "obligating" the municipality to pay the principal possibly refers only to an obligation to pass on all payments received from the corporation.

action was not a lease-sublease, but a loan. The court noted that one of the participating corporations had requested and received a private revenue ruling from the Internal Revenue Service which stated that the lump sum payment received by the corporation from the municipality would not be treated as rental income and therefore was not taxable.<sup>68</sup> The court found, in addition, that the municipality had no intent to assert a possessory interest in the facilities; the facilities were of use only at the individual plant where constructed; and the municipality had a security interest in the building which it acquired by providing the financing. Since the bonds involved municipal funds and were a loan to a private corporation, their issuance constituted a violation of the credit restriction.

This portion of *Port of Longview* raises a number of questions. Although several courts ruling on industrial development bonds have also characterized the funds loaned as "municipal funds,"<sup>69</sup> this conclusion is arguably based more on form than substance. Pollution control bonds are normally issued and sold to finance individual predetermined projects.<sup>70</sup> In this sense, the proceeds from the bond sale are already earmarked for a specific project. Although the court did not discuss it, the Washington enabling statute provided that the proceeds of any sale of bonds could only be used for the purpose for which they were issued.<sup>71</sup> Consequently, the municipality can be seen as the custodian of a special fund which is not commingled with municipal or public funds. The Washington statute provided a method for further reducing the municipality's role by allowing for the appointment of a trustee with whom all of the proceeds of the bond sale and all of the revenue raised as rent could be deposited.<sup>72</sup> Thus, although the funds loaned do move from bondholder to municipality to corporation, the municipality serves primarily as a conduit.

<sup>68</sup> 84 Wash. 2d at \_\_\_, 527 P.2d at 267 (1975). The court's conclusion that the transaction is not a lease-sublease but a loan is identical to the view of the Internal Revenue Service regarding industrial development bonds: the corporation is treated as the owner of the facilities and not a lessee. Rev. Rul. 68-590, 1968-2, CUM. BULL. 66.

<sup>69</sup> State *ex rel.* Beck v. City of York, 164 Neb. 223, 229, 82 N.W.2d 269, 273 (1957); State *ex rel.* Saxbe v. Brand, 176 Ohio St. 44, 52, 197 N.E.2d 328, 333 (1964); State v. Town of N. Miami, 59 So.2d 779, 787 (Fla. 1952). In each case the bonds were held invalid.

<sup>70</sup> Normally, the corporation approaches the municipality and requests that it issue bonds to finance a particular project. See, e.g., the procedure described in *Wilson v. Bd. of Comm'rs*, 273 Md. 30, 37, 327 A.2d 488, 492 (1974). Note also N.J. STAT. ANN. § 40:37C-11 (Supp. 1975), which requires as a condition precedent to local authorization of a particular bond issue that the particular facilities to be financed be certified as pollution control facilities.

<sup>71</sup> REV. CODE OF WASH. ANN. § 70.95A.080 (1975).

<sup>72</sup> *Id.* at §§ 70.95A.050(5).

A similar conflict between form and substance attaches to the court's determination that the bonds were municipal obligations in any more than the nominal sense. Although the Washington credit clause prohibits a municipality from loaning *its* money or credit, the court did not give any consideration to the fact that the municipality has no direct financial interest in seeing the pollution control bonds fully retired. The Washington statute contained the usual caveat that the bonds were to be secured solely by the revenue derived from the sale or lease of the facility and would not constitute a charge against the municipality's general credit or taxing power.<sup>73</sup> The courts which have not found a violation of credit restrictions have not denied that the transaction was a loan. These courts, however, have gone on to determine whether the municipality was liable for that loan. In *Port of Longview*, the court was satisfied with much less: a violation of the credit restriction exists if the bonds were issued in the municipality's name and if a private corporation borrowed the proceeds of those bonds. As a result, the Washington court's interpretation of the credit restriction is considerably broader in scope than the original purpose which these restrictions were intended to serve.

The court read the second half of the credit restriction, which prohibited loans of credit, equally broadly. Noting a House committee report which stated that the increased number of municipal bonds was causing the interest rate on tax exempts to rise,<sup>74</sup> the court concluded:

The result of the state's participation in this form of financing [*i.e.* pollution control bonds] cannot be said to have no impact on the state's ability to finance its other governmental obligations. To the extent that these transactions affect the state's ability to carry out its other functions, it is a loan of the state's credit in a very real sense.<sup>75</sup>

The court's conclusion that the bonds were a loan of credit because their issuance has a detrimental effect on the state's ability to finance other activities proves too much. Although the court was correct as to the effect of an increase in the volume of municipal bonds on the tax-exempt interest rate, the rise in interest rates is primarily a function of the economics of the bond market.<sup>76</sup> Were

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<sup>73</sup> *Id.* at § 70.95A.040(1).

<sup>74</sup> H.R. REP. No. 413, 91st Cong., 1st Sess. 172-73 (1969).

<sup>75</sup> 84 Wash.2d at \_\_\_\_, 527 P.2d at 269 (1974), *modified*, 85 Wash.2d 216, 533 P.2d 128 (1975).

<sup>76</sup> Surrey, *Federal Income Taxation of State and Local Government Obligations*, 36 TAX POLICY 5 (May-June, 1969).

the demand for tax-exempt bonds more elastic, the issuance of pollution control bonds would cause little or no rise in the interest rate. The bonds would then have a proportionally smaller impact on the state's ability to carry on its other functions. Using the *Port of Longview* definition of a loan of credit, the existence of a constitutional violation would depend on the changing structure of the tax-exempt market. Another court, presented with the argument that pollution control bonds were invalid because they would compete with traditional tax-exempt bonds to the detriment of the latter, refused to treat the issue as being judicially cognizable.<sup>77</sup> The court held that the decision to issue pollution control bonds, in the context of their effect on other municipal bonds, is a question of public policy to be decided by the legislature.

One commentator has suggested that the result in *Port of Longview* may be explained by factors not readily apparent from the opinion itself.<sup>78</sup> This commentator suggests that during oral argument the court indicated that the bonds would benefit only large corporations and that the court elsewhere had indicated its desire to see the state use strong environmental laws as a means of insuring compliance with pollution control regulations.<sup>79</sup> The *Port of Longview* opinion specifically states that municipalities will receive nothing to which they were not already entitled by law,<sup>80</sup> and the court also noted that the private corporations involved would gain "extraordinary financial benefits"<sup>81</sup> if the bonds were declared constitutional. This evidence of the court's political opposition to the bonds combined with a rather shallow interpretation of the state credit restriction indicate that the court was using the credit clause as a means for reaching a desired result. As will be seen in the next section, this approach is tantamount to applying the credit restriction as a form of public purpose test.

### B. Public Purpose Doctrine

The contrast between the scope of the credit restriction and that

<sup>77</sup> *State ex rel. Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority*, 518 S.W.2d 68, 76 (Mo. 1975).

<sup>78</sup> Note, *State Constitutions—Debt Limitations—Municipality's Issuance of Revenue Bonds To Finance Private Pollution Control Facilities Violates State Constitution*, 50 WASH. L. REV. 440 (1975).

<sup>79</sup> *Id.* at 468-71.

<sup>80</sup> *Port of Longview v. Taxpayers*, 84 Wash.2d 475, \_\_\_, 527 P.2d 263, 267 (1974), *modified*, 85 Wash.2d 216, 533 P.2d 128 (1975).

<sup>81</sup> 84 Wash. 2d at \_\_\_, 527 P.2d at 271.



of the public purpose doctrine is striking. For at least the majority of courts ruling on pollution control bonds, credit clauses are treated as narrow restrictions aimed at a specific evil: private speculation with general tax funds. The scope of review, consequently, is limited to the relationship of the public and private parties, the nature and extent of any commitment of public funds, and the existence of statutory and contractual limitations of municipal liability. On the other hand, for all of the state courts ruling on pollution control bonds, the public purpose doctrine is less of a precise legal doctrine than a broad political premise which acts as a basic limit on nearly every aspect of municipal government. That political premise is the well-accepted principle that any exercise of municipal power, including the power to tax and issue bonds, must serve a public purpose.<sup>82</sup>

The "public purpose" limitation on the power to tax and issue bonds first appeared in *Sharpless v. Mayor of Philadelphia*.<sup>83</sup> The Pennsylvania legislature had authorized Philadelphia to purchase shares of railroad stock and to raise the necessary funds by obtaining loans on the city's credit. A taxpayer brought suit and argued that the railroad bonds were invalid on the ground that they were taxation for a private purpose. The Pennsylvania Supreme Court held to the contrary, and in the process of so holding commented on the power to tax: "[t]axation is a mode of raising revenue for public purposes."<sup>84</sup> Having stated this, the court described the judiciary's role in determining public purpose as being an extremely limited one. "For us it is enough to know that the city may have a public interest in [the railroads], and that there is not a palpable and clear absence of all possible interest perceptible by every mind at the first blush."<sup>85</sup>

In *Loan Association v. Topeka*,<sup>86</sup> the Supreme Court adopted the public purpose doctrine of *Sharpless*, but not the hands-off attitude of the Pennsylvania court. The Court struck down a Kansas statute which authorized Topeka to issue bonds and donate the proceeds to a private manufacturer to encourage it to locate within the city. Although the fourteenth amendment had been ratified six years earlier, the Court did not attribute the public purpose doctrine to

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<sup>82</sup> 56 AM.JUR. 2d *Municipal Corporations* § 229 (1971); 2 E.McQUILLAN, *MUNICIPAL CORPORATIONS* § 10.31 (F.ELLARD 3d ed. 1966 Rev. Vol.).

<sup>83</sup> 21 Pa. 147 (1853) [hereinafter cited as *Sharpless*].

<sup>84</sup> *Id.* at 169.

<sup>85</sup> *Id.* at 172.

<sup>86</sup> 87 U.S. (20 Wall.) 655 (1874).

the requirements of the due process clause. Instead, as did the Pennsylvania court in *Sharpless*, the Supreme Court intuited a public purpose doctrine from a series of truisms concerning the state's power to tax.<sup>87</sup> It was not until the Supreme Court decided *Green v. Frazier*<sup>88</sup> some fifty years later that the due process clause was established as the source of the doctrine.

Definitions of public purpose are infrequently stated. In *Green v. Frazier*, the Court noted a judicial tendency to avoid defining public purpose, and instead to determine each case on its own particular circumstances.<sup>89</sup> Some broad definition is possible, however. If the underlying rationale for the concept of a public purpose is that a municipality is a public entity, endowed with a public trust,<sup>90</sup> then the legal doctrine is the judicial requirement that a municipality act consistently with that public trust. The area within which taxation is permissible is roughly coextensive with the limits of the state police power: a municipal act has a public purpose when it contributes to the health, welfare, and safety of the public.<sup>91</sup> Consequently, the similarity between the public purpose doctrine and the requirements of substantive due process is not coincidental.<sup>92</sup> Both doc-

<sup>87</sup> "When [taxation] is prostituted to objects in no way connected with the public interests or welfare, it ceases to be taxation and becomes plunder." *Sharpless v. Mayor of Philadelphia*, 21 Pa. 147, 169 (1853). "This power [to tax] can as readily be employed against one class of individuals and in favor of another, so as to ruin the one class and give unlimited wealth and prosperity to the other, if there is no implied limitation of the uses for which the power may be exercised." *Loan Ass'n v. Topeka*, 87 U.S. (20 Wall.) 655, 664 (1874).

<sup>88</sup> 253 U.S. 233 (1920). This case did not concern state aid to private corporations; on the contrary, several North Dakota statutes were challenged which enabled the state to directly engage in a number of private enterprises. The Supreme Court upheld the legislation, returning to the deferential public purpose test of *Sharpless*. "When the constituted authority of the State undertakes to exert the taxing power, and the question of the validity of its action is brought before this court, every presumption in its favor is indulged . . ." *Green v. Frazier*, 253 U.S. 233, 239 (1920).

<sup>89</sup> *Id.* at 240.

<sup>90</sup> "A municipal corporation is a public institution created to promote public, as distinguished from private, objects. All its power, property and offices constitute a public trust to be administered by its authorities." 2 E.McQUILLAN, *MUNICIPAL CORPORATIONS* § 10.31 (F.ELLARD 3d ed. 1966 Rev. Vol.).

<sup>91</sup> See *Fickes v. Missoula County*, 155 Mont. 258, 268, 470 P.2d 287, 292 (1970); *State ex rel. Hammermill Paper Co. v. La Plante*, 58 Wis.2d 32, 56 n.8, 205 N.W.2d 784, 798 n.8 (1973). Cf. *Berman v. Parker*, 348 U.S. 26, 32 (1954), where the Supreme Court held that eminent domain, a municipal power subject to practically the same public purpose test as the taxing power, comes under the heading of state police power.

<sup>92</sup> Compare, *Lochner v. New York*, 198 U.S. 45 (1905), a classic example of a restrictive substantive due process test, with *Stanley v. Dep't of Conservation and Dev.*, 284 N.C. 15, 199 S.E.2d 641 (1973). For application of the less restrictive doctrines of substantive due process and public purpose, see *Nebbia v. New York*, 291 U.S. 502 (1934), and *Wilson v. Bd. of County Comm'rs*, 273 Md. 30, 327 A.2d 488 (1974).

trines have their constitutional base in the due process clause and each provides the judiciary with a broad substantive test of new government programs.

The definition of a public purpose sharpens slightly when contrasted with a "private" purpose. The public must receive some benefit from the municipal act.<sup>93</sup> No apparent public benefit is present if a municipality arbitrarily appropriates \$1,000 for a private corporation.<sup>94</sup> On the other hand, considerably less difficulty in finding a public purpose exists when a municipality contracts with that corporation to build a school or purchase a fire engine.<sup>95</sup> Pollution control bonds fall somewhere in between; they are not an outright gift nor are they a contractual purchase of goods or services. Yet a private corporation is benefiting from municipal action and, arguably, municipal funds are involved.<sup>96</sup>

A number of issues arise when the public purpose doctrine is applied to pollution control bonds. The first issue is general in nature, and arises whenever a court tests the validity of a statutory purpose: to what degree will the court require proof that the statute has a public purpose? State courts have generally refused to overrule legislative determinations of public purpose unless "clearly wrong" or "manifestly arbitrary and incorrect."<sup>97</sup> The pollution control bond cases have also adopted this deferential approach.<sup>98</sup>

<sup>93</sup> "The right of the public to receive and enjoy the benefit of the use [of public funds] determines whether the use is public or private." 56 AM. JUR. 2d *Municipal Corporations* § 230 (1971).

<sup>94</sup> Opponents of the bonds could argue that, at the least, the bonds are an indirect appropriation of municipal funds. See note 96, *infra*.

<sup>95</sup> See 15 E. McQUILLAN, *MUNICIPAL CORPORATIONS* § 43.31 (J. Latta 3rd ed. 1970 Rev. Vol.) for a list of municipal bonds issued for specific purposes which have been held to serve a public purpose.

<sup>96</sup> The argument has been made that the public purpose doctrine is inappropriate to test pollution control bonds because no public funds are involved. *Wilson v. Bd. of County Comm'rs*, 273 Md. 30, 43-44, 327 A.2d 488, 495 (1974) (court applied public purpose test without deciding whether bonds involved use of public funds because rule in Maryland is that exemptions from state taxation must serve a public purpose); *State ex rel. Brennan v. Bowman*, 89 Nev. 330, 332-33, 512 P.2d 1321, 1322 (1973) (court held that bonds did not constitute public funds spent for private purposes since no public funds were involved and because purpose was public). The difficulty with arguing that the public purpose doctrine is inappropriate because no public funds are involved is that the doctrine limits all municipal acts and not simply the power to tax or issue bonds. See note 82, *supra*. Second, even if the bond agreement provides that the corporation will pay all costs of issuing the bonds, presumably some public employee time will always exist which is not paid for by the corporation and which the municipality must cover. Thus, some public funds will always be involved.

<sup>97</sup> 15 E. McQUILLAN, *MUNICIPAL CORPORATIONS* § 43.29 (J. Latta 3rd ed. 1970 Rev. Vol.); 56 AM. JUR. 2d *Municipal Corporations* § 230 (1971).

<sup>98</sup> *E.g.*, *Harper v. Schooler*, 258 S.C. 486, 496, 189 S.E.2d 284, 289 (1972) ("clearly wrong");

Three other issues concern the various criteria by which the bonds are to be judged. First, do the bonds yield any public benefit and, if so, how much public benefit constitutes a public purpose? Equations have been offered: one commentator has suggested that, in general, a community must receive value proportionate to the value it gives.<sup>99</sup> Another has gone further and concluded that a public purpose exists only when the community receives more in benefits than it gives to the private party.<sup>100</sup>

To the degree that either of these standards requires a court to weigh and compare private and public benefits, the court is improperly assuming a legislative role. As noted, the public purpose doctrine is little more than a vague truism by which a court is able to substitute its evaluation of the statute's public benefit for that of the legislature. Basic questions of the existence or non-existence of a public benefit are political questions best answered by politicians.<sup>101</sup> For that reason, the desirable public purpose test is the least restrictive one. By focusing solely on the validity of the purpose of the statute and avoiding a balancing of benefits, the courts are least likely to overrule judgements best made by legislators. A statutory purpose should be considered "public" so long as it is not manifestly clear that the public will receive no benefit.

The second issue raised by the public purpose test as applied to pollution control bonds concerns the judicial effect to be given the statutory means, that is, the use of tax-exempt bonds to provide direct financial aid to private corporations. Beginning with *Sharpless* the argument has been made and accepted that the existence of *direct* public aid to a private business or an individual pre-

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State *ex rel.* Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority, 518 S.W.2d 68, 74 (Mo. 1975) ("arbitrary and unreasonable"); Wilson v. Bd. of County Comm'rs, 273 Md. 30, 49, 327 A.2d 488, 498 (1974) ("[I]t is only necessary that the legislative determination to spend a particular amount of public funds be reasonable and based on an honest judgement . . . that the expenditure is for the best interests of the city," quoting Williamsport v. Sanitary Dist., 247 Md. 326, 332, 231 A.2d 40, 44 (1967)).

<sup>99</sup> Note, *The "Public Purpose" of Municipal Financing For Industrial Development*, 70 YALE L.J. 789, 796 (1961).

<sup>100</sup> Note, *Restricting Revenue Bond Financing of Private Enterprise*, 52 N.C.L. REV. 859, 862 (1974).

<sup>101</sup> One commentator has offered two characteristics of the appropriate "public purpose" decisionmaker: the capacity to make the most expert analysis and the ability to best determine what values are most important to the community in a given situation. This commentator concluded that the appropriate decisionmaker would usually not be a court, but offered several reasons why industrial development bonds may be an exception. Note, *The "Public Purpose" Of Municipal Financing For Industrial Development*, 70 YALE L.J. 789, 796-97 (1961).

cludes any finding of a public purpose.<sup>102</sup> Of the pollution control bond cases, only the North Carolina Supreme Court in *Stanley v. Department of Conservation and Development*<sup>103</sup> has adopted this reasoning.

The final issue appears less frequently in the pollution control bond case law. Does a public purpose exist when the plant intending to use the bonds is, at the time, in violation of state pollution control regulations, has been ordered to comply, and apparently has the means to privately finance the required facilities? Industrial development bonds were intended to encourage particular discretionary corporate action: relocation within or near the issuing municipality. But, in those cases where a plant is under a pre-existing obligation to provide pollution control facilities, arguably, no element of corporate discretion remains.<sup>104</sup> If the city is entitled to receive that which it is issuing the bonds to acquire, are those bonds issued for a public purpose? The remainder of this article will discuss the majority view response to these issues, and *Stanley*.

The principal task faced by the majority courts has been to determine what the purposes of the bonds are and whether those purposes are "public." The courts have found two categories of public benefits, economic and environmental, each sufficient to constitute a public purpose. First, the courts have taken judicial notice and accepted legislative findings as to the positive economic effect of the bonds. The opinions cite as "public purpose benefits" the increased attractiveness of the area to new industry by virtue of the availability of the bonds,<sup>105</sup> decreased unemployment,<sup>106</sup> and an increase in tax revenue.<sup>107</sup>

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<sup>102</sup> To justify any exercise of the power [to levy taxes] requires that the expenditure which it is intended to meet shall be for some public service, or some object which concerns the public welfare. The promotion of the interest of individuals, either in respect of property or business, although it may result incidentally in the advancement of the public welfare, is, in its essential character, a private and not a public object. *However certain and great the resulting good to the general public*, it does not, by reason of its comparative importance, cease to be incidental. *Lowell v. City of Boston*, 111 Mass. 454, 460-61 (1873) (emphasis added).

<sup>103</sup> 284 N.C. 15, 199 S.E.2d 641 (1973) [hereinafter cited as *Stanley*].

<sup>104</sup> Compare Peterson and Galper, *supra* note 2, at 84, where the authors argue that present federal laws allow corporations little discretion, with Roberts, *River Basin Authorities: A National Solution to Water Pollution*, 83 HARV. L. REV. 1527, 1530 (1970), where the author offers several reasons why a corporation might decide to delay compliance with pollution regulations.

<sup>105</sup> *State ex rel. Brennan v. Bowman*, 89 Nev. 330, 333, 512 P.2d 1321, 1322 (1973); *State v. County Dev. Authority*, 249 So.2d 6, 10 (Fla. 1971).

<sup>106</sup> *State ex rel. Brennan v. Bowman*, 89 Nev. 330, 333, 512 P.2d 1321, 1322 (1973); *Fickes v. Missoula County*, 155 Mont. 258, 268, 470 P.2d 287, 292 (1970).

<sup>107</sup> *Fickes v. Missoula County*, 155 Mont. 258, 268, 470 P.2d 287, 292 (1970).

In addition, several courts have indicated that the pollution control facilities need not create new sources of employment or increase tax revenue in order to serve a public purpose. The bonds will be valid even if they only maintain the present economic level. In *State v. Putnam County Development Authority*,<sup>108</sup> the state argued that the statute which authorized the bonds required a project to have a positive effect on the area economy, while the planned pollution control facilities would merely maintain the economic status quo. The court, which had already noted that the particular plant applying for the bonds employed an annual average of 2,500 people,<sup>109</sup> disagreed:

The economic contribution of the project is amply demonstrated in the trial judge's final judgement. He found that Hudson is one of the major industries located in Putnam County and provides employment opportunities to a large number of Putnam County inhabitants. The curtailment or termination of operations would cause Hudson to discharge a large number of its employees, in an area where other, ready employment would not likely be available.<sup>110</sup>

Another court has come to a similar conclusion, holding that the bonds served a public purpose by tying a plant already located in the state more closely to its present location.<sup>111</sup>

The courts' determination of the economic benefits of pollution control bonds can be analyzed on two levels: whether the conclusions are factually correct and whether the result is judicially proper. As to factual correctness, the experience with industrial development bonds indicates that the bonds are unlikely to attract new industry.<sup>112</sup> It is even debatable whether the bonds will stabilize a community's present economic level. For those marginally profitable plants in danger of closing down, pollution control bonds may not promise sufficient savings to warrant any expenditures for the necessary pollution control facilities.<sup>113</sup>

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<sup>108</sup> 249 So.2d 6 (Fla. 1971).

<sup>109</sup> *Id.* at 10.

<sup>110</sup> *Id.* Hudson, the corporation, had until January 31, 1973 to comply with an order of the Florida Air and Water Pollution Control Commission. The court noted that failure to comply would subject Hudson to fines of up to \$5,000 a day. 249 So.2d at 8.

<sup>111</sup> *Wilson v. Bd. of County Comm'rs*, 273 Md. 30, 51, 327 A.2d 488, 499 (1974).

<sup>112</sup> See note 26 *supra* and accompanying text.

<sup>113</sup> "[I]t is difficult to believe that most industrial polluters just happen to be poised so close to the margin of decision that the small [tax] incentives that have been proposed will suddenly make cooperation rather than delay a preferred strategy in many instances." Roberts, *River Basin Authorities: A National Solution to Water Pollution*, 83 HARV. L. REV. 1527, 1532 (1970).

Nevertheless, exactly because it is at least debatable whether the bonds have any desirable economic effect indicates that the decisions which find a public purpose are judicially correct. The court's role should be limited to examination of the statute's ultimate purpose. Since the legislature's declared economic purposes are not manifestly arbitrary and unreasonable, the courts should inquire no further.

The second type of public benefit from pollution control bonds, entirely aside from any economic benefits, is the resulting pollution control facilities which should abate or eliminate pollution in the community. The courts have held that pollution control per se is a public purpose,<sup>114</sup> reasoning that the concept of public purpose is not static but a function of the increasing needs of the community.<sup>115</sup> In *Wilson v. Board of County Commissioners of Allegheny County*,<sup>116</sup> the Maryland Supreme Court recognized that in an earlier time, pollution abatement may not have been considered a proper governmental function. However, this court and others have found ample evidence that pollution control is presently a matter of great public concern and, thus, is a public purpose.<sup>117</sup>

The courts' conclusion that the pollution control facilities will reduce pollution, as a factual matter, is less open to debate than the question of their economic effectiveness. Furthermore, the courts are correct to recognize that the public purpose doctrine, by definition, must be an expanding concept. For that reason, public concern over pollution is a valid basis for a court to find that pollution control programs have a public purpose. Nevertheless, having concluded that pollution control is a public purpose, few of the courts have gone on to consider whether it is relevant that the corporate borrower may be under order to provide the facilities for which it seeks financing.<sup>118</sup> This lack of discussion may be explained by the

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<sup>114</sup> *Harper v. Schooler*, 258 S.C. 486, 496, 189 S.E.2d 284, 289 (1972); *Opinion of the Justices*, 359 Mass. 769, 772, 268 N.E.2d 149, 151 (1971); *Kennecott Copper Corp. v. Town of Hurley*, 84 N.M. 743, 745, 507 P.2d 1074, 1076 (1973).

<sup>115</sup> *State ex rel. Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority*, 518 S.W.2d 68, 74 (Mo. 1975); *Wilson v. Bd. of County Comm'rs*, 273 Md. 30, 46, 327 A.2d 488, 496 (1974); *State ex rel. Hammermill Paper Co. v. La Plante*, 58 Wis.2d 32, 55, 205 N.W.2d 784, 798 (1973).

<sup>116</sup> 273 Md. 30, 327 A.2d 488 (1974) [hereinafter cited as *Wilson*].

<sup>117</sup> *Id.* at 46, 327 A.2d at 496; *State ex rel. Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority*, 518 S.W.2d 68, 74 (Mo. 1975); *Kennecott Copper Corp. v. Town of Hurley*, 84 N.M. 743, 745, 507 P.2d 1074, 1076 (1973).

<sup>118</sup> For instances where the corporate borrower was not in compliance with governmental pollution control regulations, see generally *Harper v. Schooler*, 258 S.C. 486, 491, 189 S.E.2d 284, 286 (1972); *Stanley v. Dep't of Conservation and Dev.*, 284 N.C. 15, 22, 199 S.E.2d 641,

courts' approach: once a public purpose has been found how the legislature chose to pursue that purpose is immaterial. More importantly, if one purpose of the bonds is to induce corporate compliance with pollution control regulations quickly and without economic chaos, those plants already under order to comply are the most logical candidates for the bonds.<sup>119</sup>

In *Wilson*, the taxpayer-appellant argued that the existence of such an order to comply negated any finding that pollution control is a public purpose. The court disagreed. It found that the purpose of the Maryland statute and § 103(c)(4)(F) of the Internal Revenue Code was to assist corporations to meet a given goal.<sup>120</sup> The court appeared to be influenced by what it considered to be the public stake in reaching that goal. Insofar as the purpose of the statute was pollution control, the court went to great lengths to demonstrate the "interest of vast portions of our populace in matters of environment,"<sup>121</sup> and noted that without such interest the facilities would have never been required in the first place. Although not mentioned in the court's discussion of this issue, the *Wilson* opinion began by commenting on the importance to the county of the plant as an employer.<sup>122</sup> In short, the court saw the public as having an interest in ensuring that employers are financially able to comply with pollution control regulations, which in turn, the public has an interest in having enforced. Thus, the existence of a compliance order would not lessen the statute's public purpose.

Arguably, although a compliance order alone will not negate a public purpose, it should have a negative effect if a corporation under order is able to privately finance the required facilities.<sup>123</sup> A court that would strike down a statute for failing to include restrictions as to who may apply for the bonds would be saying, pollution control bonds for small corporations or those without adequate fi-

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646 (1973); *State v. County Dev. Authority*, 249 So.2d 6, 8 (Fla. 1971); *Wilson v. Bd. of Comm'rs*, 273 Md. 30, 37, 327 A.2d 488, 492 (1974).

<sup>119</sup> The California pollution control bond statute specifically gives a higher priority to those projects necessary to meet federal, state, or local deadlines for controlling pollution created by already-existing facilities. CAL. HEALTH AND SAFETY CODE § 39616 (West Supp. 1975), amending CAL. HEALTH AND SAFETY CODE § 39616 (West 1973).

<sup>120</sup> *Id.* at 52, 327 A.2d at 499.

<sup>121</sup> *Id.* at 47, 327 A.2d at 497.

<sup>122</sup> "The Company has a plant at Luke in Allegheny County. Its 2,000-man payroll is of substantial importance to a county with a population as reflected by the 1970 census of approximately 84,000 people." 273 Md. at 32, 327 A.2d at 489-90.

<sup>123</sup> The statute discussed in *Opinion of the Justices*, 359 Mass. 769, 268 N.E.2d 149 (1971), required a state official to certify that the applicant for the loan was unable to construct the facilities without the assistance of the state. Mass. Acts 1970, ch. 746, § 1.



nancing do serve a public purpose, but pollution control bonds for Exxon do not. The difficulty with this approach is twofold. First, it puts a court in the position of either examining the balance sheet of each corporate user whose bonds are being challenged, or holding the statute invalid on its face. The second difficulty is that it ignores the legislative purpose of the statute which is to abate pollution and avoid economic dislocation. A legislature could reasonably have concluded that the quickest way to induce compliance with pollution regulations is to offer an economic incentive. Correctly applied, the public purpose doctrine should avoid testing the means of implementation chosen by the legislature.

A number of courts have commented on this ends/means distinction in another context: the legislative choice to provide direct aid to private corporations as the method for stabilizing the local economy and cleaning the environment. Discussions of this issue have included occasionally confusing and contradictory statements about direct and indirect benefit, primary and incidental beneficiaries, and ultimate and secondary purposes.<sup>124</sup>

First, pollution control bonds are clearly a source of direct aid and benefit to the corporate borrowers, as contrasted with the indirect benefit which all industry receives from the existence of a state vocational school, or even the benefit which one particular plant may receive from the construction of a nearby highway. Rather, the municipality provides direct assistance to the corporation with the intent that the resulting corporate action benefit the public. The courts have held that the existence of this direct private benefit does not per se preclude a finding of public purpose. The focus has been on the ultimate purpose of the bonds, whether the court has determined it to be unemployment reduction or pollution abatement, and not on the "private" status of the catalyst. If the ultimate purpose of the bonds is valid, then regardless of the private benefits conferred by the bonds, the public is considered the primary beneficiary.<sup>125</sup> In other words, the intent or "purpose" of the legislature controls, not an objective determination of who gains most.

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<sup>124</sup> Compare *State v. County Dev. Authority*, 249 So.2d 6, 12 (Fla. 1971); *State ex rel. Farmers' Electric Cooperative, Inc. v. State Environmental Improvement Authority*, 518 S.W.2d 68, 72 (Mo. 1975); *Opinion of the Justices*, 359 Mass. 769, 771, 268 N.E.2d 149, 151 (1971); *Stanley v. Dep't of Conservation and Dev.*, 284 N.C. 15, 38, 199 S.E.2d 641, 656 (1973).

<sup>125</sup> "The mere fact that the money raised will go to individuals will not condemn the act in question, since the test is not as to who receives the money, but, is the purpose for which it is to be expended a public purpose?" *Fickes v. Missoula County*, 155 Mont. 258, 268, 470 P.2d 287, 292 (1970), quoting *Kraus v. Riley*, 107 Mont. 116, 124, 80 P.2d 864, 867 (1938).

Again, the courts are correct to limit their determination to the validity of the bond's ultimate purpose. Statutory authorization of pollution control bonds raises the presumption that the legislature has concluded that loaning the proceeds of tax-exempt revenue bonds to private corporations is an effective way for a municipality to acquire certain public benefits. The public purpose doctrine has been criticized for stifling new government programs.<sup>126</sup> By focusing on means as well as purpose, a court would be setting an improper restriction on state government. *Stanley v. Department of Conservation and Development* is an excellent example of that form of judicial restriction.

In *Stanley*, the court prefaced its discussion of the case with an outline of the public purpose doctrine as established by North Carolina precedent. First, an activity cannot be for a public purpose unless it is properly the "business of government." A proper function of government is not to aid a private business unless the private sector has shown its unwillingness or inability to meet a public need.<sup>127</sup> Second, aid to a private business by tax-exempt revenue bonds is not justified by the "incidental" advantage to the public which results from the prosperity and promotion of private enterprise. Third, in determining public purpose, the court will look not only at the end sought by the statute but at the means to be used.

The court questioned two aspects of the planned issuance of pollution control bonds: their necessity and their form. In *Mitchell v. North Carolina Industrial Development Financing Authority*,<sup>128</sup> the same court had struck down an industrial development bond statute because, in part, it could not find any need for the bonds sufficient to warrant government aid to private corporations. The court took judicial notice that no widespread unemployment existed in the state and that the North Carolina economy was still expanding.<sup>129</sup> Similarly, in *Stanley*, the court was unable to find a need for pollution control bonds. Pollution control facilities are simply another cost of doing business which a corporation must include in the price of its goods.<sup>130</sup> More specifically, the court could find no element of "inability or unwillingness" on the part of private enterprise:

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<sup>126</sup> Holmberg, *Municipal Powers and the Public Purpose Doctrine*, 21 ROCKY MT. L. REV. 277 (1949); Tew, *Industrial Bond Financing and the Florida Public Purpose Doctrine*, 21 U. MIAMI L. REV. 171 (1966).

<sup>127</sup> As an example of that type of situation, the court cited two instances in which it had upheld revenue bonds issued by public housing authorities for low income housing. 284 N.C. at 33, 199 S.E.2d at 653.

<sup>128</sup> 273 N.C. 137, 159 S.E.2d 745 (1968).

<sup>129</sup> *Id.* at 156, 159 S.E.2d at 758.

<sup>130</sup> 284 N.C. at 38, 199 S.E.2d at 656.

There is no finding that Albemarle [the corporation] is unable to provide the required facilities at its own expense and without outside assistance. Indeed, upon the argument of these cases, defendant conceded that Albemarle is able to correct the pollution it creates and that construction of the necessary facilities is in progress.<sup>131</sup>

The court did not limit its holding to those cases where the corporation is able privately to finance the required facilities. It indicated that pollution control bonds are prohibited by the public purpose doctrine even where a corporation is unable to comply with a state order without state aid and the only alternative is to cease operations.<sup>132</sup>

The rationale of this holding that, in effect, pollution control bonds can never serve a public purpose, is the court's determination that the form of the transaction rather than its ultimate purpose is controlling. The court readily conceded that pollution is a major social problem and that pollution control is necessary for the public health, safety, and welfare.<sup>133</sup> Unlike the majority view courts, the *Stanley* court stated that the existence of a public purpose per se is insufficient: "[d]irect assistance to a private entity may not be the means used to effect a public purpose."<sup>134</sup> Direct assistance to a private corporation can only yield an incidental benefit to the public, notwithstanding the legislative purpose of the statute or the amount of public benefit.

In a Massachusetts advisory opinion, the primary and incidental beneficiaries were determined in light of the statute's principal purpose.<sup>135</sup> The Massachusetts court determined that purpose to be pollution control rather than subsidization of private industry. Consequently, the primary beneficiary was the public and not the corporate borrower. In *Stanley*, however, the court equated "direct recipient" with "primary beneficiary." "The conclusion is inescapable

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<sup>131</sup> *Id.*

<sup>132</sup> *Id.* at 39, 199 S.E.2d at 657.

<sup>133</sup> *Id.* at 36, 199 S.E.2d at 655. In this context, the court distinguishes between the state police power to regulate pollution levels and the state taxing power. The court notes that the former is more extensive than the latter and concludes that a state can eliminate pollution through use of regulations and sanctions but not by assisting a corporation to finance the cost of the required facilities. 284 N.C. at 37, 199 S.E.2d at 656. The validity of a distinction between police power and taxing power is questionable. Many elements of a pollution control regulatory scheme could require government expenditures and thus, taxation. For example, the state would probably purchase testing equipment and hire inspectors. In fact, the expense of regulation could exceed the minimal municipal expenses required to issue pollution control bonds.

<sup>134</sup> 284 N.C. at 34, 199 S.E.2d at 653.

<sup>135</sup> Opinion of the Justices, 359 Mass. 769, 771, 268 N.E.2d 149, 151 (1971).

that Albemarle is the only direct beneficiary of the tax-exempt revenue bonds . . . and that the benefit to the public is only incidental or secondary."<sup>136</sup> For a bond to have a public purpose the public must be the direct recipient of the funds; private enterprise cannot serve as a catalyst.

The North Carolina court concluded that pollution control bonds are not properly "the business of government." It is noteworthy that *Stanley* represented the second time the North Carolina legislature had passed industrial development or pollution control bond legislation.<sup>137</sup> Where such a clear and continuing conflict over the question of public purpose is present, the presumption should favor the legislative determination. *Stanley* recognized that the concept of public purpose "must expand . . . to meet the necessities of changed times and conditions . . . ."<sup>138</sup> The court then confused issues when it deviated from consideration of the statutory purpose to the statutory means. As a result of decisions such as *Stanley*, the North Carolina legislature is barred from pursuing a number of concededly public purposes because of the use of direct public aid to private corporations.<sup>139</sup>

The relationship between the credit clause restriction and the public purpose test is helpful for unraveling statutory means from purpose. As has been suggested, the courts use the public purpose doctrine act inappropriately when they seek more than a rational basis for pollution control bond statutes. This test would be satisfied by a finding that pollution control and economic stabilization are the statutory purposes and are reasonably likely to yield some public benefit. But state courts are not foreclosed from also testing the statutory means, since the very purpose of the credit restriction is to examine the means chosen and to identify loans to private corporations resulting in municipal debt or liability. Neither the credit

<sup>136</sup> 284 N.C. at 38, 199 S.E.2d at 656.

<sup>137</sup> In *Mitchell v. Indus. Dev. Fin. Authority*, 273 N.C. 137, 159 S.E.2d 745 (1968), the court struck down a statute authorizing the issuance of industrial development bonds. Since *Stanley*, the North Carolina General Assembly has passed a constitutional amendment authorizing industrial development and pollution control bonds. N.C. SESS. LAWS 1973, ch. 1222.

<sup>138</sup> 284 N.C. at 33, 199 S.E.2d at 653.

<sup>139</sup> See *Foster v. Medical Care Comm'n*, 283 N.C. 110, 195 S.E.2d 517 (1973), where the court struck down a statute authorizing the North Carolina Medical Care Commission to issue revenue bonds to finance hospital construction. The statute provided that the hospitals could be leased to private non-profit corporations which would acquire title to the hospitals after retiring the bonds through rent payments. The court held that the statute had no purpose apart from the operation of the hospital by, and the ultimate conveyance to, the private lessee and therefore lacked a public purpose. 283 N.C. at 127, 195 S.E.2d at 528.

restriction nor the public purpose test, however, should be read so broadly as to subsume the function of the other.

### CONCLUSION

Pollution control bonds today have much in common with industrial development bonds just prior to the 1968 tax reform: pollution control bond sales have increased dramatically over a short period of time and are presently being used by major corporations for large projects;<sup>140</sup> the great majority of states are issuing the bonds and the case law suggests that very few state courts will find them invalid.<sup>141</sup>

In addition to statistical similarities, pollution control bonds are subject to many of the same criticisms which were aimed at industrial development bonds. From an economic point of view, the bonds are still growing in volume and continue to compete with general obligation bonds, causing the interest rate on all municipal bonds to rise, with the attendant detrimental effect on municipal budgets. The bonds also create the same loss of federal tax revenue, quantitatively and qualitatively, as industrial development bonds.<sup>142</sup> Finally, from an environmental point of view, a number of commentators have questioned the effectiveness of using tax incentives to induce corporate compliance with pollution control regulations.<sup>143</sup>

In short, many of the same abuses and failings which prompted the original 1968 reform have reappeared, and the federal government will probably act soon to limit the volume of pollution control bonds. The Secretary of the Treasury has indicated his desire to limit use of the bonds to financing new facilities added to plants in operation before January 1, 1975,<sup>144</sup> and the Treasury has recently released new proposed regulations regarding pollution con-

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<sup>140</sup> In 1975, the average pollution control bond issue equaled \$11,057,689. *The Weekly Bond Buyer*, Jan. 26, 1976, at 10, col. 1.

<sup>141</sup> Thirty-four states or their political subdivisions issued pollution control bonds in 1975. *Id.*

<sup>142</sup> It has been estimated that by 1980, the public will pay \$1.5 billion per year in tax loss and higher interest payments on public debt in order to reduce private industrial pollution control investment by \$550 million annually. The rest of the public cost will go directly to bondholders as higher income. Peterson and Galper, *supra* note 2, at 82.

<sup>143</sup> Reitze and Reitze, *Tax Incentives Don't Stop Pollution*, 57 A.B.A.J. 127 (1971); McDaniel and Kaplinsky, *The Use of the Federal Income Tax System to Combat Air And Water Pollution: A Case Study In Tax Expenditures*, 1 ENV. AFF. 12 (1971); Note, *The Limited Tax-Exempt Status of Interest on Industrial Development Bonds Under Subsection 103(c) of the Internal Revenue Code*, 85 HARV. L. REV. 1649 (1972).

<sup>144</sup> Tax Notes, July 14, 1975, at 16.

trol bond use which are considered more restrictive than the present regulations.<sup>145</sup> Nevertheless, hopeful reformers should not consider state courts as the source of one solution to the pollution control bond problem. An effective solution, if one is desired, must originate in Congress or with the Treasury.

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<sup>145</sup> Proposed Treas. Reg. § 1.103-8, 40 Fed. Reg. 36371 (1975).